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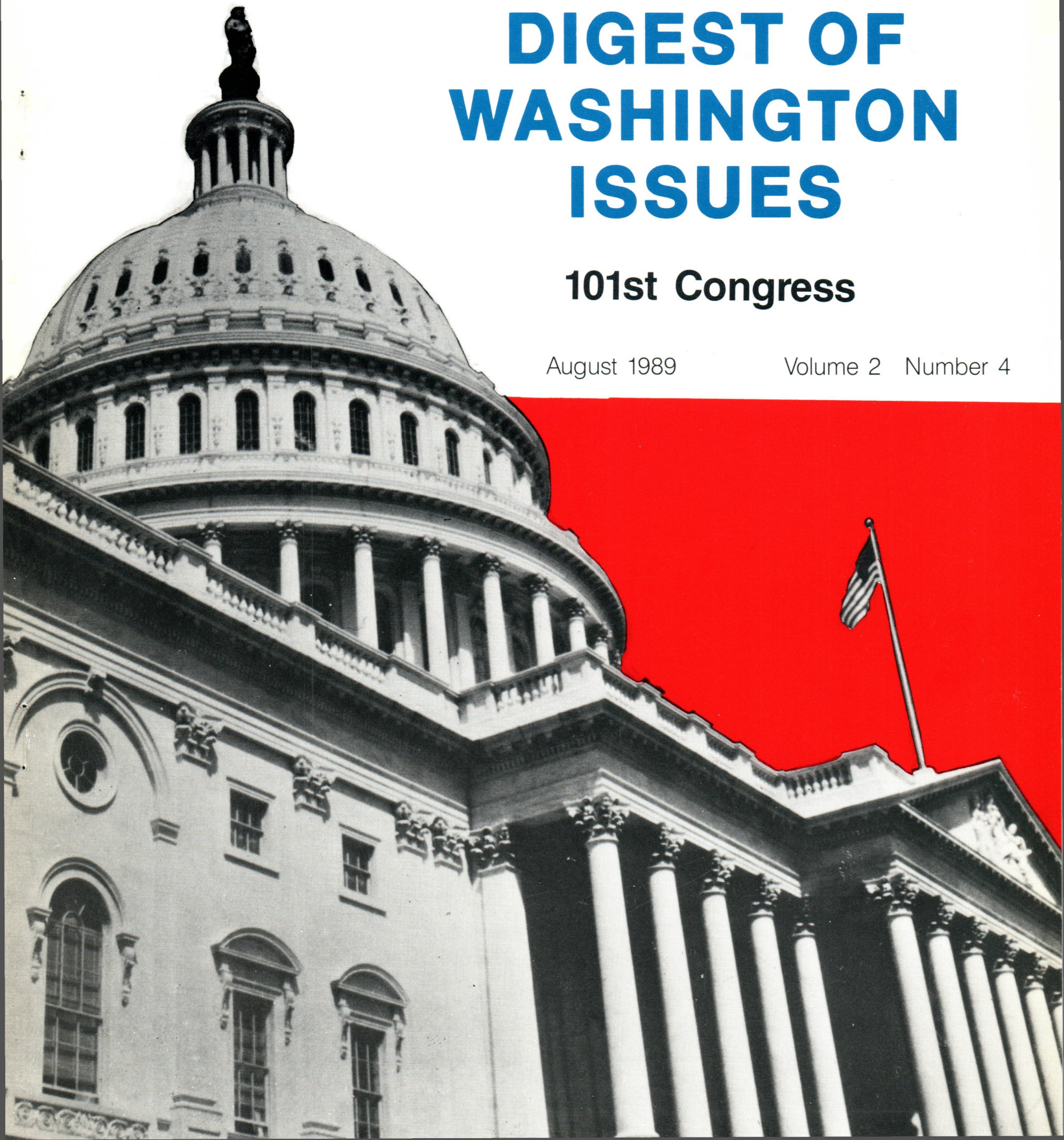

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DIGEST OF WASHINGTON ISSUES

(Boldface type in the text of the Digest indicates material added since the last issue. The date in the lower right hand corner of the pages indicates the date material on the page was changed.)

Financial Institutions Reform, Recovery and Enforcement Act

The bill to bail out the savings and loan industry originally passed by the Senate included provisions which would have expanded the federal role in regulating audits and auditors of depository institutions and limited legal defenses available to auditors of these institutions. The AICPA worked to have the bill amended and conferees modified the provisions to address the concerns of the accounting profession. For further details see page 4.

Racketeer Influenced and Corrupt Organizations Act (RICO)

Amending the civil provisions of the Racketeer Influenced and Corrupt Organizations Act (RICO) of the 1970 Organized Crime Control Act has been a major goal of the AICPA since the 99th Congress. RICO permits private parties to sue for treble damages and attorneys' fees when those individuals have been injured by a "pattern of racketeering activity" in certain relationships to an "enterprise." Because such crimes as mail fraud, wire fraud, and securities fraud are included in the RICO law, many accountants are named as co-defendants in suits arising out of regular business failures, securities offerings, and other investment disappointments. For further details see page 5.

Congressional Oversight of the SEC's Enforcement and the Accounting Profession's Performance Under the Securities Laws

The Oversight and Investigations Subcommittee of the House Energy and Commerce Committee has conducted 23 hearings since 1985 focusing on the effectiveness of independent accountants who audit publicly owned corporations and the performance of the SEC in meeting its responsibilities. The AICPA believes independent auditors are fulfilling their obligations under the federal securities laws. In order to enhance the effectiveness of independent audits, the AICPA has strengthened audit quality by expanding peer review requirements, by revising auditing standards on internal controls, fraud and illegal acts, by recommending to the SEC expanded disclosure requirements when an auditor resigns from an audit engagement, and by creating the National Commission on Fraudulent Financial Reporting. For further details see page 6.

Department of Labor Office of Inspector General Reports on ERISA Pension Plan Security

Two reports critical of audits of private pension plans have been issued by the Department of Labor's Office of Inspector General (OIG). Stricter standards and expanded responsibilities for independent qualified public accountants were advocated by the OIG. The AICPA testified at an August 2, 1989 hearing on the matter conducted by the House Government Operations Subcommittee on Employment and Housing. The AICPA testimony emphasized that audits conducted in accordance with generally accepted auditing standards are not designed to assure compliance with regulatory requirements. The AICPA conveyed the message that the Congress must be explicit about what it requires if the auditor's work is to be expanded beyond an audit of the financial statements of a covered plan. For further details see page 7.

Improved Federal Financial Management

The federal government of the United States operates the largest financial organization in the world. Yet it does not provide complete, consistent, reliable, useful and timely information about its operations and financial conditions. The AICPA believes it is time for the Congress to enact legislation that will require more effective financial management systems and accountability. For further details see page 8.

Litigation Reform

Because accountants have become easy targets for plaintiffs when the accountants are the only survivors after the failure of a client company and because accountants are often perceived as having "deep pockets," increasing numbers of lawsuits are being brought against them. The AICPA believes that it is essential that tort litigation reform legislation be enacted in order to reduce accountants' legal liability. For further details see page 9.

Telemarketing Fraud Legislation

Legislation has been introduced in the House designed to curb fraud and other abuses in telemarketing. The importance of the legislation from the point of view of the accountancy profession is to ensure that the terms are defined precisely enough so that legitimate businesses using the telephone in routine business transactions will not be covered. Imprecise language could result in the federalization of all common law fraud claims in commercial litigation. For further details see page 10.

Legislation to Create SRO for Investment Advisers

Proposed legislation drafted by the SEC to create one or more self-regulatory organizations (SROs) for investment advisers by amending the Investment Advisers Act of 1940 has been introduced in the House and Senate. The SROs would establish qualification and business practice standards, perform inspections, and enforce compliance with the law, under SEC oversight. Since the Investment Advisers Act of 1940 contains an exemption for accountants, this legislation does not directly affect the accounting profession and the AICPA has not taken a position on it. For further details see page 11.

Consultant Registration and Certification

Last year Congress included a provision in the Fiscal Year 1989 Department of Defense authorization bill requiring the Office of Federal Procurement Policy to promulgate conflict of interest standards for federal government consultants, as well as registration, certification, and enforcement requirements. The proposed policy was issued in June 1989. Legislation has also been introduced in the 101st Congress which would require consultants submitting proposals to perform services for federal government agencies to register and submit such information as client names and a description of the services furnished to each client. The AICPA does not believe that such registration and certification requirements would provide the most effective and efficient method of ferreting out conflict of interest situations. For further details see page 12.

New SEC Enforcement Powers

The final report of the National Commission on Fraudulent Financial Reporting, more commonly known as the Treadway Commission, included recommendations to expand the SEC's enforcement authority. Implementation of some of the recommendations would require amendment of our nation's securities laws. As a result, legislation has been introduced in the House and Senate that would permit assessment of new civil money penalties in administrative and civil proceedings under the federal securities laws. The bills also would allow the SEC to ask a court to suspend or bar violators from serving as directors or officers of public companies. This legislation does not directly affect the accounting profession; therefore, the AICPA has not formally adopted a position on it. For further details see page 13.

The Quality of Audits of Federal Financial Assistance

The House Government Operations Legislation and National Security Subcommittee began a series of hearings in November 1985 on the quality of audits of federal grants to state and local governments and to nonprofit organizations. In 1986 and 1987 the General Accounting Office released three reports substantiating the need for improved audit quality and making recommendations about how it could be achieved. A task force formed by the AICPA to develop ways to improve the quality of audits of governmental units issued a report containing 25 recommendations. In 1988, a status report about the accounting profession's enforcement efforts was issued by the GAO which commended AICPA and State Boards of Accountancy enforcement efforts. For further details see page 14.

Repeal or Modification of Section 89

The Tax Reform Act of 1986 included language setting mandatory non-discrimination rules for employers' health and welfare plans prohibiting employers from discriminating in favor of highly compensated employees. Because the resulting section 89 of the Internal Revenue Code contains extremely complex rules for determining whether certain employee benefit plans are discriminatory, repeal or modification of section 89 is one of the AICPA's top priorities. For further details see page 15.

Civil Tax Penalty System Revisions

Civil tax penalties have proliferated during the past 10 years resulting in a complex system. The Congress, IRS, and tax professionals have all recognized the need to develop a less confusing system. **In the House, civil tax penalty reform legislation, H.R. 2528, which was approved by the Ways and Means Committee June 2, 1989, has been included in the Fiscal Year 1990 budget reconciliation bill.** The AICPA testified in support of H.R. 2528 at a Ways and Means Oversight Subcommittee hearing on the measure. For further details see page 16.

Leveraged Buyouts

Leveraged buyouts (LBOs) and other debt-laden corporate deals have been the subject of numerous hearings by various Congressional committees, including the House Ways and Means and Senate Finance Committees. Arthur S. Hoffman, chairman of the AICPA Federal Taxation Executive Committee, testified at a March 1989 Ways and Means Committee hearing in opposition to using the Internal Revenue Code as a mechanism to curb LBOs. For further details see page 17.

Other Tax Issues

Two issues are addressed: 1) tax simplification and 2) a budget proposal by President Reagan that a user fee be considered for the IRS' telephone assistance program for taxpayers. The AICPA Tax Division has established a subcommittee to identify specific areas of the tax laws in need of simplification and to work with Congress and the Treasury on their implementation. The AICPA wrote to President Bush urging that a proposal for a user fee on IRS' telephone taxpayer assistance be eliminated from future budgets. For further details see page 18.

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT

ISSUE: Should the federal role in regulating the audits and auditors of depository institutions be expanded. Should the defenses available to accountants in lawsuits arising from failed or failing depository institutions be severely limited.

BACKGROUND: The Congress, on August 4, 1989 passed legislation, H.R. 1278, to reform, recapitalize, and consolidate the federal deposit insurance system and to enhance the regulatory and enforcement powers of the federal agencies charged with regulating our federal financial institutions.

The Senate passed version of the bill included provisions that would have had adverse effects on the accounting profession. The provisions would have expanded the federal role regulating audits and auditors of depository institutions, and limited the legal defenses available to auditors of these institutions.

STATUS: **H.R. 1278, the Financial Institutions Reform Recovery and Enforcement Act, which was signed by President Bush on August 9, 1989, was amended to address the concerns of the accounting profession.**

AICPA POSITION: The AICPA worked to have modified the provisions of H.R. 1278 which were of concern to the accounting profession.

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J. T. Higginbotham - Vice President, Legislative Affairs
M. H. Parker - Technical Manager, Federal Government Division

RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

ISSUE: Should the civil provisions of the Racketeer Influenced and Corrupt Organizations (RICO) Act be amended to protect routine business activities which are not connected to "organized crime," "racketeers," or the "mob" from such allegations and litigation.

BACKGROUND: RICO is the part of the 1970 Organized Crime Control Act which authorizes private parties injured by a "pattern" of "racketeering activity" to sue for treble damages and attorneys' fees. Despite the fact that Congress intended the statute to be used as a tool to fight organized crime, RICO is commonly used in commercial litigation since the law includes mail fraud, wire fraud, and securities fraud in its description of racketeering activities. Increasingly, accountants are included as co-defendants in these cases. The U.S. Supreme Court has twice refused to narrow the scope of the civil provisions of RICO, ruling that it is the Congress, not the courts that must correct the abuse of the RICO statute. However, efforts to amend RICO's civil provisions were unsuccessful in the 99th and 100th Congresses.

In the 101st Congress, RICO reform legislation has again been introduced. Rep. Rick Boucher (D-VA) has introduced H.R. 1046 and Sen. Dennis DeConcini (D-AZ) has introduced S. 438.

The bills include the following provisions:

- Plaintiffs would be permitted to recover only single damages in most RICO cases, including cases involving the federal securities and commodities laws, and cases where one business sues another business.
- Automatic treble damages would be permitted to be recovered by most governmental entities and in cases against defendants who have been convicted of related felonies.
- Consumers, victims of insider trading, and persons injured by certain crimes of violence would be permitted to recover their actual damages plus punitive damages, up to twice the actual damages.
- Treble damages in pending cases would not be allowed, unless the court found such disallowances to be "clearly unjust," in cases for which the new law would provide only single damages.
- An affirmative defense for defendants who acted in reliance on certain state or federal regulatory actions would be included in the legislation.

STATUS: The House Judiciary Crime Subcommittee has held three hearings on H.R. 1046; **the most recent hearing was held on July 20, 1989.** The Senate Judiciary Committee has held one hearing on S. 438.

AICPA POSITION: The AICPA supports the legislation and has been involved in efforts to amend civil RICO since the 99th Congress.

AICPA STAFF CONTACTS: B. Z. Lee - Deputy Chairman, Federal Affairs
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CONGRESSIONAL OVERSIGHT OF THE SEC'S ENFORCEMENT AND THE ACCOUNTING PROFESSION'S PERFORMANCE UNDER THE SECURITIES LAWS

ISSUE: Are independent auditors fulfilling their responsibilities relative to audits of publicly owned corporations?

BACKGROUND: In February 1985, under the chairmanship of Rep. John Dingell (D-MI), the Subcommittee on Oversight and Investigations of the House Energy and Commerce Committee began hearings on the accounting profession. The hearings focused on the effectiveness of independent accountants who audit publicly owned corporations and the performance of the SEC in meeting its responsibilities.

To date, 23 oversight hearings have been held and 153 witnesses have testified. Representatives of the AICPA have testified on three occasions. There have been no hearings in the Senate.

STATUS: No hearings have been held in the 101st Congress.

AICPA POSITION: Independent auditors are fulfilling their responsibilities concerning audits of publicly owned corporations. In addition, the profession has taken a number of steps to enhance the effectiveness of independent audits. These include:

- o Strengthening audit quality by expanding the scope and requirements for peer review conducted under the supervision of the Institute's SEC Practice Section and the Public Oversight Board.
- o Revising auditing standards on internal control, fraud and illegal acts, auditors' communications and other "expectation gap issues."
- o Creating the National Commission on Fraudulent Financial Reporting, chaired by former SEC Commissioner James C. Treadway.
- o Recommending to the SEC expanded disclosure requirements when an auditor resigns from an audit engagement, particularly when there are questions about management's integrity.

AICPA STAFF CONTACTS: B. Z. Lee - Deputy Chairman, Federal Affairs
J. F. Moraglio - Vice President, Federal Government Division

DEPARTMENT OF LABOR OFFICE OF INSPECTOR GENERAL REPORTS ON ERISA PENSION PLAN SECURITY

ISSUE: Effectiveness of audits in monitoring compliance with ERISA.

BACKGROUND: The Employee Retirement Income Security Act (ERISA) is designed to provide safety and security for retirement plan funds. The U.S. Government, through the Pension Benefit Guaranty Corporation, stands behind the private pension plans system. The Department of Labor is responsible for overseeing the system.

The Department of Labor's (DOL) Office of Inspector General (OIG) has issued two reports critical of audits of private pension plans. The first report, issued in December 1987, was based on a review of information of selected ERISA plans and identified some audit and reporting deficiencies. The second report, the Inspector General's Semiannual Report to Congress for the period ending March 31, 1989, advocated stricter standards and expanded responsibilities for independent qualified public accountants (IPAs) and criticized the adequacy of audit reports by IPAs on private pension plans. The report was also critical of the Labor Department's oversight of the pension plan assets and said that an unknown portion of those assets may be at risk.

A third DOL OIG report is expected to be issued in September 1989 based on the OIG's review of 300 reports and audit workpapers.

STATUS: Additional hearings may be held in the fall by the House Government Operations Employment and Housing Subcommittee.

AICPA POSITION: The AICPA takes seriously any allegation of poor audit quality. Following the release of the 1987 Inspector General's report, the AICPA met with representatives of the Labor Department to determine what the AICPA could do to address the matters discussed in the report. The Institute's 1983 Audit and Accounting Guide, Audits of Employee Benefit Plans, is being revised. On August 2, 1989, the AICPA testified before the House Government Operations Subcommittee on Employment and Housing on this matter. The AICPA testimony emphasized that audits conducted in accordance with generally accepted auditing standards are not designed to assure compliance with regulatory requirements and that if the Congress wishes the independent auditor to expand the scope of work beyond an audit of the financial statements of a covered plan, it must be explicit in what it requires.

AICPA STAFF CONTACTS: J. F. Moraglio - Vice President, Federal Government Division
I. A. MacKay - Director, Federal Government Division

IMPROVED FEDERAL FINANCIAL MANAGEMENT

ISSUE: Should the U.S. Government adopt meaningful financial practices.

BACKGROUND: Although the government of the United States is the world's largest financial operation, its financial management concepts and practices are weak, outdated and inefficient. Its books are kept on a cash basis and many departments and agencies do not follow the established accounting principles. Annual independent financial audits are not required and, with few exceptions, neither are they performed. In addition, many obsolete and incompatible accounting systems are scattered throughout the federal agencies.

STATUS: **The AICPA Task Force on Improving Federal Financial Management has prepared an issues and solutions discussion memorandum scheduled to be issued September 1, 1989 and has also scheduled a national, by invitation only, colloquium on this issue for December 11, 1989.** The colloquium will bring together members of Congress, the General Accounting Office, the Administration, the news media, the accounting profession, and other interested parties to discuss what Congress and the Administration can do to improve the federal government's financial management.

AICPA POSITION: The AICPA is concerned about the federal government's lack of effective financial management systems and accountability and it urges the legislative and executive branches to work together to improve this situation.

The AICPA Task Force on Improving Federal Financial Management has developed recommendations to assist the Congress and the Administration in improving federal financial management. These recommendations include:

- Establishing the office of chief financial officer for the federal government and controllers for each executive department and agency who would implement a requirement for government-wide financial accounting and reporting, including related systems.
- Establishing a uniform body of accounting and financial reporting standards for the federal government to be used by all departments and agencies.
- Mandating the issuance of annual financial statements at the department and agency level, and government-wide prepared in accordance with established standards in a complete, consistent, reliable, and timely manner.
- Mandating a program of independent audits to provide annually to the President, the Congress, and the American people an independent opinion on the financial statements of the federal government and its agencies.

AICPA STAFF CONTACTS: J. F. Moraglio - Vice President, Federal Government Division
S. L. Graff - Technical Manager - Federal Government Division

LITIGATION REFORM

ISSUE: Should Congress enact legislation which would reform the present parameters of tort litigation?

BACKGROUND: In our litigious society, accountants have become easy targets for plaintiffs when the accountants are the only survivors after the failure of a client company. The issue of accountants' liability is of great concern to the AICPA membership. A specially formed AICPA task force on accountants' legal liability has been charged with the responsibility of identifying ways to reduce our liability exposure. For the last two years, the task force has directed much of its attention to the various tort reform efforts within the states. On the federal level, it has focused on the civil RICO reform effort.

STATUS: S. 1100, the Lawsuit Reform Act of 1989, was introduced by Senator Mitch McConnell (R-KY) on June 1, 1989 and is strongly supported by the AICPA. S. 1100 would abolish joint and several liability in civil actions in federal and state courts based on any cause of action, including economic losses. The AICPA task force and representatives of other business, professional, and public service groups worked with Senator McConnell's staff in developing S. 1100.

AICPA POSITION: The AICPA believes the chief cause of the liability crisis is a tort system which has become dangerously out of balance as the result of a trend of expanding liability. We recognize that legitimate grievances require adequate redress, but fairness demands equity for the defendant as well as the plaintiff. Such equity is now lacking in the system, and the balance must be restored.

The AICPA has identified five principal areas in need of legislative reform:

- o Proportionate Liability. The most significant area in need of reform is the replacement of the prevailing rule of "joint and several" liability with "several" liability alone, in federal and state actions predicated on negligence, which would protect a defendant from paying more than his proportionate share of the claimant's loss relative to other responsible persons.

- o Suits by Third Parties - The Privity Rule. The second target area for reform is the promotion of adherence to the privity rule as a means of countering the growing tendency to extend accountants' exposure to liability for negligence to an unlimited number of unknown third parties with whom the accountant has no contractual or other relationship.

- o Racketeer Influenced and Corrupt Organizations Act (RICO). Please see the RICO issue section of the Digest (page 5).

- o Costs and Frivolous Suits. Another prime concern is deterrence of the increasing numbers of frivolous suits and attorneys' fees arrangements that provide incentives for the plaintiffs' bar to file lawsuits against "deep pocket" defendants regardless of merit.

- o Aiding and Abetting Liability. The AICPA also believes there is a need to clarify the scienter or knowledge standard by which auditors may be held secondarily liable for aiding and abetting a violation of law by those who are primarily responsible. Specifically, the AICPA supports legislative reforms to require a finding of actual knowledge by the CPA of the primary party's wrongdoing.

AICPA STAFF CONTACT: P. V. Geoghan - Assistant General Counsel

TELEMARKETING FRAUD LEGISLATION

ISSUE: Whether Congress, in seeking to combat "telemarketing fraud," should carefully craft legislation to ensure that any private cause of action does not become a vehicle for federalizing all common law fraud claims in commercial litigation.

BACKGROUND: During the last Congress, the House, in response to the problem of fraud and other abuses in telemarketing, passed a bill introduced by Rep. Tom Luken (D-OH). The bill could have been interpreted to permit any person, who could meet a $10,000 threshold requirement, to bring suit in federal court if he believed that fraud had been committed in connection with products or services sold, in part, by the use of a telephone. Such a provision was called the "son of RICO" by the FTC chairman last year, who warned that it would federalize common law fraud to a greater degree than the civil RICO statute had already done. The Judicial Conference of the United States also stated that such a provision would generate a volume of litigation that would "dwarf" the volume of civil RICO suits.

Rep. Luken reintroduced similar legislation, H.R. 1354, on March 9, 1989, but it did include some notable changes. First, H.R. 1354 did not permit a private party to bring suit unless the party has suffered at least $50,000 in damages, compared with $10,000 under last year's bill. Second, H.R. 1354's definition of "telemarketing" was narrower than that contained in the measure he introduced in the last Congress, although ambiguities that might permit a broad interpretation of the statute remained.

At a March 16, 1989 hearing on H.R. 1354 held before the Subcommittee on Transportation and Hazardous Materials of the House Committee on Energy and Commerce, several witnesses testified that the bill's provisions should be narrowed even further to ensure that legitimate businesses not engaged in "telemarketing" are not inadvertently brought within the bill's terms.

The AICPA noted its concern about the broad application of H.R. 1354, as it was originally drafted, in a letter to Rep. Luken and urged that the measure be amended so that it effectively addressed true telemarketing fraud. In April, the definition of the term "telemarketing" was amended by the Transportation and Hazardous Materials Subcommittee for all purposes under the bill. As approved by the subcommittee, the term "telemarketing" would not include any sales transaction where there was a face-to-face meeting, prior to the consummation of the sale, between the seller of services or his agent and the purchaser or his agent, even if the telephone was otherwise used to initiate, pursue, or consummate the sale. Therefore, as long as the effort to sell accounting services included at least one meeting in person with representatives of the potential client, the accounting services sold subsequently would not be considered sold through telemarketing. As a consequence, the rules and regulations and causes of action created by the bill could not be used to bring claims for damages allegedly arising from, or related to, that sale of those accounting services.

STATUS: The full Energy and Commerce Committee has not yet considered H.R. 1354. No similar legislation has been introduced in the Senate.

AICPA POSITION: The AICPA supports efforts to ensure that the terms used in any federal telemarketing fraud legislation are not so broad that the statute could be construed to cover the activities of legitimate businesses that use the telephone in the course of engaging in routine business transactions.

AICPA STAFF CONTACT: B. Z. Lee - Deputy Chairman, Federal Affairs

LEGISLATION TO CREATE SRO FOR INVESTMENT ADVISERS

ISSUE: Should Congress create a self-regulatory organization (SRO) for investment advisers.

BACKGROUND: Individuals who fit the definition of investment adviser under the Investment Advisers Act of 1940 are required to register with the SEC, unless they qualify for one of the Act's exceptions. The SEC is authorized to inspect their books and records, establish certain disclosure requirements, and bring civil actions for fraud and other securities law violations. However, because there is no SRO for investment advisers, the SEC must conduct direct examinations. The SEC's limited budget allows it to inspect investment advisers once every twelve years. While the SEC targets higher risk investment advisers for more frequent inspections and while periodic investigations are also conducted by state regulators, this has not proven to be adequate to prevent fraud and illegal activity. In addition, other individuals who operate as investment advisers are not required to register with the SEC either because they fall within one of the exceptions of the 1940 Act or because they do not give financial advice about securities.

An increasing number of investment advisers and instances of consumer fraud have resulted in Congressional and public interest in finding a means to regulate investment advisers.

A Congressional hearing conducted in 1986 by the House Energy and Commerce Subcommittee on Telecommunications, Consumer Protection, and Finance found that a "majority" of investment advisers operate honestly, but that of those defrauding investors, many fall outside the authority of the SEC.

In September 1988, the SEC proposed a rule which would exempt small-scale investment advisers from SEC registration requirements and shift those responsibilities to the states. The rule has not been adopted.

In June of this year, the SEC submitted draft legislation to the Congress authorizing the SEC to register one or more national investment adviser associations to provide a self-regulatory mechanism for investment advisers by amending the Investment Advisers Act of 1940. The SROs would establish qualification and business practice standards, perform inspections, and enforce compliance with the law, under SEC oversight.

STATUS: The SEC's draft proposal was introduced in the House and Senate at the end of July. In the House, H.R. 3054 was introduced by Rep. John Dingell, the chairman of the House Energy and Commerce Committee, and was co-sponsored by 12 other members of the committee. In the Senate, S. 1410, was introduced by Senators Christopher Dodd (D-CT) and John Heinz (R-PA), the chairman and ranking minority member, respectively, of the Senate Banking Subcommittee on Securities. Hearings are expected in the House and Senate.

AICPA POSITION: Since the Investment Advisers Act of 1940 contains an exemption for accountants, this legislation does not directly affect the accounting profession and the AICPA has not taken a position on it. However, the AICPA's Governmental Affairs Committee voted at its August 11, 1989 meeting to closely monitor Congressional action on the measures and to vigorously defend the current accountants' exception in the 1940 Act.

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CONSULTANT REGISTRATION AND CERTIFICATION

ISSUE: Should consultants who render services to the federal government or persons who contract with the federal government be required to register and identify conflict of interest situations.

BACKGROUND: Last year, the Congress included a provision in the Fiscal Year 1989 Defense Authorization legislation that charged the Administrator of the Office of Federal Procurement Policy (OFPP) with promulgating a government-wide policy which would set forth: 1) conflict of interest standards for persons who provide consulting services to the federal government; and 2) procedures, including such registration, certification, and enforcement requirements as may be appropriate, to promote compliance with the conflict of interest standards.

In June 1989, the OFPP issued the proposed conflict-of-interest policy. The OFPP policy letter establishes 1) government-wide policy relating to conflict of interest standards for persons who provide consulting services to the U.S. government and to persons who contract with the U.S. government and 2) procedures, such as registration, certification, and enforcement requirements, to promote compliance with those standards.

S. 166 and H.R. 667 were introduced this year and would require the registration and certification of federal government consultants. The bills are identical and would create a registration requirement for consultants working directly for the federal government or doing work for a contractor who is working for the government. The legislation defines a consultant as any person or organization which is a party to a contract with the federal government that furnishes "advisory and assistance services." This includes management and professional services.

STATUS: **The AICPA will comment on the proposed OFPP policy letter on conflicts of interest. The legislation has not progressed.**

AICPA POSITION: The AICPA believes that registration and certification of all consultants would not provide the most effective and efficient method of ferreting out conflict of interest situations.

AICPA STAFF CONTACTS: J. F. Moraglio - Vice President, Federal Government Division
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NEW SEC ENFORCEMENT POWERS

ISSUE: Does the SEC need new enforcement powers?

BACKGROUND: In its final report released in October 1987, the National Commission on Fraudulent Financial Reporting (the Treadway Commission) made several recommendations which may require amending our nation's securities laws. The Treadway Commission recommended expanding the SEC's enforcement authority to enable the agency to:

- o bar or suspend officers and directors of publicly held corporations;
- o mandate audit committees composed of independent directors for all publicly held corporations;
- o seek civil money penalties in injunctive proceedings;
- o issue cease and desist orders when it finds a securities law violation; and
- o impose civil money penalties in administrative proceedings, including Rule 2(e).

In February 1989, H.R. 975, legislation drafted by the SEC in response to the Treadway Commission's recommendations, was introduced in the House by Rep. John Dingell (D-MI), the chairman of the House Energy and Commerce Committee. In March, a similar measure, S. 647, was introduced by Senators Chris Dodd (D-CT) and John Heinz (R-PA). They are, respectively, the chairman and ranking minority member of the Securities Subcommittee of the Banking, Housing and Urban Affairs Committee, which has jurisdiction over the legislation.

H.R. 975 and S. 647 would permit assessment of new civil money penalties in administrative and civil proceedings under the federal securities laws, and would allow the SEC to ask a court to suspend or bar violators from serving as directors or officers of public companies. The legislation does not apply to Rule 2(e) proceedings and does not address mandated audit committees.

A GAO report requested by Rep. Dingell was also released in March concerning implementation of the Treadway Commission recommendations. The report stated that the public accounting profession has "taken positive actions which demonstrate a commitment to addressing concerns about audit quality and the accuracy and reliability of financial disclosures." The GAO found that the accounting profession "has made substantial progress in addressing problems by expanding the auditor's responsibilities to: 1) evaluate internal controls; 2) provide early warning of a company's financial difficulties; 3) design the audit to provide reasonable assurance of detecting material fraud; and 4) improve communication to the financial statement user and the management of public companies. In releasing the report, Rep. Dingell said, "The GAO found that the accounting profession has made substantial progress in addressing the Treadway Commission's proposals, and the profession deserves credit for that."

STATUS: The Senate Securities Subcommittee held a hearing on S. 647 on April 18, 1989. No hearings have been held in the House on H.R. 975.

AICPA POSITION: This legislation does not directly affect the accounting profession; therefore, the AICPA has not formally adopted a position on it.

AICPA STAFF CONTACTS: B. Z. Lee - Deputy Chairman, Federal Affairs
J. F. Moraglio - Vice President, Federal Government Division

THE QUALITY OF AUDITS OF FEDERAL FINANCIAL ASSISTANCE

ISSUE: Improving the quality of audits of federal financial assistance.

BACKGROUND: In November 1985, the House Government Operations Legislation and National Security Subcommittee began hearings on the quality of audits of federal grants to state and local governments and to nonprofit organizations.

Three General Accounting Office (GAO) studies released in 1986 and 1987 identified problems related to governmental audits by CPAs. The studies concluded that improvements must be made in the quality of those audits and determined that audits are most likely to meet professional standards if there is an effective procurement process.

In June 1988, the GAO issued a report commending the AICPA and State Boards of Accountancy enforcement efforts. The chairman of the Government Operations Committee commended the Institute for its efforts but requested the AICPA to reevaluate its policy about disclosing disciplinary actions taken against CPAs. In August 1988, the AICPA replied by stating it agreed with the need for public disclosure of all disciplinary actions taken against CPAs performing substandard work once a trial board has made an actual determination of a member's guilt.

STATUS: In May 1989, the AICPA Implementation Monitoring Committee released its final report. The report stated that 23 of the 25 recommendations made by the Task Force on the Quality of Audits of Governmental Units in 1987 have been implemented.

AICPA POSITION: The AICPA recognized the urgency of this problem and moved to correct it. The Institute formed the Task Force on the Quality of Audits of Governmental Units to recommend ways to improve audit quality. The AICPA also established the Implementation Monitoring Committee to determine the extent that the task force recommendations were implemented.

Other actions taken by the AICPA include publication of a revised audit guide on audits of state and local governmental units, issuance of a statement on auditing standards on compliance auditing, presentation of training programs throughout the country on the Single Audit Act, and expansion of the peer review program of the Division for CPA Firms to include examination of the audits of governmental units. The Institute has also established a Certificate in Educational Achievement program in Governmental Accounting and Auditing.

AICPA STAFF CONTACTS: J. F. Moraglio - Vice President, Federal Government Division
S. L. Graff - Technical Manager - Federal Government Division

REPEAL OR MODIFICATION OF SECTION 89

ISSUE: Should section 89 of the Internal Revenue Code be repealed or substantially amended.

BACKGROUND: The Tax Reform Act of 1986 included language, now Internal Revenue Code section 89, setting mandatory non-discrimination rules for employers' health plans. The effect of the language would deny tax benefits for plans which discriminate in favor of highly compensated employees. A series of complex tests is required of employers to prove that their plans do not discriminate in favor of benefits for higher-paid employees.

STATUS: Various measures to repeal or modify section 89 were introduced early in the 101st Congress. The momentum for modification or repeal of section 89 grew in Congress following the issuance of revised IRS regulations on March 7. As a result, the chairmen of the House Ways and Means Committee and the Senate Finance Committee, the tax writing committees in the Congress, introduced legislation to modify section 89. Rep. Dan Rostenkowski (D-IL) introduced H.R. 1864 in April and Senator Lloyd Bentsen (D-TX) introduced S. 1129 in June.

The Senate attached section 89 simplification provisions to S. 5, the Act for Better Child Care Services for 1989, which was approved by the Senate in June. The House Ways and Means Committee has included section 89 language in H.R. 3150, the Revenue Reconciliation Act of 1989, which is aimed at reducing the budget deficit. The Congress will resume work on the reconciliation legislation when it reconvenes in September. Both the House and Senate have also approved a moratorium on the use of funds in Fiscal Year 1990 by the Treasury Department to implement section 89. Differences exist between the House and Senate versions of the moratorium legislation, as well as the provisions to simplify section 89, and must be resolved by House and Senate conferees.

AICPA POSITION: The AICPA has supported repeal or modification of section 89 since January 1989. AICPA representatives have been meeting for months with members of Congress and their staffs in an effort to have section 89 modified. In March, the AICPA Tax Division Executive Committee proposed an alternative approach which would enable employers to avoid section 89 entirely if their more highly paid employees report some or all of the health care premium as income. In May, the AICPA testified at hearings conducted by the Senate Finance Committee and the House Committee on Ways and Means. On June 12, 1989 the AICPA wrote to Senator Bentsen endorsing his bill which would dramatically simplify the section 89 testing requirements. The AICPA believes that certain provisions contained in the bill should be retained in the final version of the bill agreed to by the Congress. These provisions include: postponing the deadline until 1990; eliminating the need to identify high paid and low paid workers; changing the maximum employee contribution to 40 percent; and including special provisions for small businesses with fewer than 21 employees. However, a concern exists with respect to S. 1129's treatment of cafeteria plans and the AICPA has made several suggestions to correct the problems.

AICPA STAFF CONTACTS: D. H. Skadden - Vice President, Federal Taxation Division
L. A. Winton - Technical Manager, Federal Taxation Division

CIVIL TAX PENALTY SYSTEM REVISIONS

ISSUE: Whether and in what ways the civil tax penalty system should be changed to make the sanctions fair, effective, and administrable.

BACKGROUND: In the past 10 years, a proliferation of civil tax penalties has created a system which is complex, confusing, uncoordinated, and often duplicative. There is general agreement that revisions to the civil tax penalty provisions are necessary.

Five Congressional hearings have been held regarding the need for revision of the civil tax penalty system, and the AICPA testified at three of those hearings.

In February 1989, the final report of the IRS Executive Task Force on Civil Tax Penalties was released at a hearing before the Oversight Subcommittee of the House Ways and Means Committee. The AICPA also testified at that hearing, at the conclusion of which the subcommittee chairman, J.J. Pickle (D-TX), invited the AICPA and the IRS to join his subcommittee staff members on a task force to develop legislation to reform the tax penalty structure.

STATUS: Rep. Pickle introduced H.R. 2528, the Improved Penalty Administration and Compliance Tax Act, on June 1, 1989. An amended version of H.R. 2528 was approved by the full Ways and Means Committee on June 20.

H.R. 2528 is included in H.R. 3150, the Revenue Reconciliation Act of 1989, which is aimed at reducing the budget deficit. Congress will resume work on the reconciliation legislation when it reconvenes in September.

AICPA POSITION: The immediate concerns with the civil tax penalty system can be addressed with a few modifications to existing penalties and the repeal of superfluous provisions. The Institute testified in support of H.R. 2528 at a June 6 Ways and Means Oversight Subcommittee hearing on the measure.

AICPA STAFF CONTACTS: D. H. Skadden - Vice President, Federal Taxation Division
K. F. Thomas - Director, Federal Taxation Division

LEVERAGED BUYOUTS

ISSUE: Whether Congress should pass legislation restricting leveraged buyouts (LBOs), other forms of corporate debt financing, and corporate mergers.

BACKGROUND: Congressional concern about hostile takeovers has grown steadily in recent years. With the takeover of RJR-Nabisco in November of 1988, the concern about LBOs escalated.

A hearing in December 1988 by the House Energy and Commerce Subcommittee on Telecommunications and Finance was the first of 20 hearings held to date by Congressional committees, including the House Ways and Means and Senate Finance Committees. The House Banking Committee has also conducted hearings, as well as the House Education and Labor Subcommittee on Labor-Management Relations. Despite the number of hearings, no consensus has developed about what action, if any, the Congress should take.

The AICPA testified at a March 14, 1989 hearing of the Ways and Means Committee regarding the tax policy aspects of mergers and acquisitions. The AICPA urged that the tax law should not be used to restrict highly leveraged transactions. The testimony cited four major reasons for not using the tax code to restrict LBOs:

- o Complexity. The complexity added to the tax law would defy compliance and enforcement.
- o Scope. The practical difficulties of identifying the targeted transactions are immense. In addition, any simple tactic, such as a blanket disallowance of a deduction for interest, would impact the wrong targets.
- o Efficiency and Effectiveness. In the area of mergers and acquisitions, the tax law has frequently proven to be an inefficient and ineffective vehicle to discourage the use of highly leveraged transactions.
- o Favoritism. Foreign purchasers not subject to restrictive U.S. tax laws would be accorded an advantage over their American competitors.

STATUS: **In the Senate, Finance Committee Chairman Senator Lloyd Bentsen (D-TX) introduced S. 1506 on August 3, 1989. S. 1506 would limit the ability of corporations to obtain a refund of taxes by carrying back net operating losses arising from excess interest deductions allocable to transactions reducing corporate equity. The bill was referred to the Finance Committee. In the House, the Ways and Means Committee has approved, as part of H.R. 3150, the Revenue Reconciliation Act of 1989, a package of tax-related curtailments aimed at corporate mergers and acquisitions. Included are provisions on certain original issue discount obligations, employee stock ownership plans, foreign individuals, and information reporting. The Congress will resume work on the reconciliation legislation when it reconvenes in September.**

AICPA POSITION: The AICPA opposes using the Internal Revenue Code as a vehicle to address perceived problems with LBOs and other debt-laden corporate transactions.

AICPA STAFF CONTACTS: D. H. Skadden - Vice President, Federal Taxation Division
C. K. Shaffer - Technical Manager, Federal Taxation Division

OTHER TAX ISSUES

o TAX SIMPLIFICATION:

A Tax Division Subcommittee, Tax Simplification and Efficiency, has been established. Its mission: to promote an enhanced awareness of the need to consider simplification and efficiency in future tax legislative and regulatory activity; to identify specific areas in existing tax law in need of simplification; and, to work with Congress and the Treasury on the implementation of simplification proposals.

The subcommittee has developed a preliminary package of simplification discussion points and met with government tax policy representatives on a number of occasions to discuss this effort. The subcommittee is actively seeking additional ideas and input.

The Chairman is Jay Starkman, of Atlanta, Georgia. Individuals should send any ideas for simplifying the tax system to: Tax Simplification Ideas, AICPA, 1455 Pennsylvania Ave., N.W., Washington, D.C. 20004. AICPA staff contacts are D. H. Skadden and C. B. Ferguson.

o USER FEE FOR TAX INFORMATION:

President Reagan's Fiscal Year 1990 budget included a proposal that a user fee be considered for the IRS' taxpayer telephone assistance program. The AICPA wrote President Bush in February opposing inclusion of such a provision in his budget.

The letter stated, "Voluntary compliance by the citizens of this country is a key ingredient to the proper functioning of our tax system. Decreasing the information flow to taxpayers by interposing the user fee disincentive, particularly given the extreme complexity of the tax system, will invariably reduce voluntary compliance and ultimately reduce government revenues."

The provision was included in President Bush's budget and the AICPA has met with officials at the Office of Management and Budget (OMB) to urge that such a user fee not be imposed. A task force with representatives from IRS, OMB and Treasury has been formed to study whether it is feasible, with presently available technology, to charge a user fee. The task force is to issue its report later this year. The decision about whether to impose a user fee will be made after the report is issued. AICPA staff contacts are D. H. Skadden and E. S. Karl.

OTHER ISSUES

Some of the other regulatory, legislative and political issues that the AICPA is monitoring include:

- **Pending SEC release to require all independent accountants to undergo periodic peer review**
- **Comprehensive review by the SEC Chief Accountant's Office of the SEC's independence rules applicable to accountants**
- Parental and medical leave
- Mandatory health care coverage
- European Community Common Market Trade Agreement EURO (1992)
- Financial problems in the insurance industry
- GAAP/RAP issues
- Capital gains tax proposals
- Tax options for revenue enhancement
- Defense contractor legislation

If you would like additional details on any of these issues, please contact our office.

AICPA PROFILE

HISTORY

The American Institute of Certified Public Accountants (AICPA) was founded in 1887. Its creation marked the emergence of accountancy as a profession, distinguished by its educational requirements, high professional standards, strict code of professional ethics, licensing status, and commitment to serving the public interest.

The AICPA is the national professional association of certified public accountants in the United States. Members are CPAs from every state and territory of the United States, and the District of Columbia. Currently, there are over 285,000 members. Approximately 46 percent of those members are in public practice, and the other 54 percent include members working in industry, education, government, and other various categories.

OBJECTIVES

In its continuing effort to serve the public interest, the Institute creates and grades the Uniform CPA Examination, develops auditing standards, upholds the Code of Professional Ethics, provides continuing professional education and contributes technical advice to government and to private sector rule-making bodies in areas such as accounting standards, taxation, banking and thrifts.

LEADERSHIP

The Chairman of the AICPA Board of Directors is elected from the membership and serves a one-year term. The AICPA chairman for 1988-1989 is Robert L. May of Short Hills, NJ. The chairman-elect is Charles Kaiser, Jr. of Los Angeles, CA.

Philip B. Chenok, CPA, is the President and Chief Executive Officer of the AICPA. Bernard Z. Lee, CPA, is Deputy Chairman - Federal Affairs.

The AICPA Council is the association's policy-making governing body. Its 260 members represent every state and U.S. territory. The Council meets twice a year.

The Board of Directors acts as the executive committee of Council, directing Institute activities between Council meetings. The 21 member Board of Directors includes 3 public members, all of whom are lawyers and 2 of whom are former SEC officials. The Board meets five times a year.

The AICPA has a permanent staff of nearly 700 and a budget of $90 million. The work of the AICPA is done primarily by its volunteer members serving on approximately 130 boards, committees, and subcommittees.